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IN THE

SUPREME COURT OF THE UNITED STATES.

OCTOBER TERM, 1954.

OBEAR-NESTER GLASS COMPANY,
Petitioner,

v.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

No. 478.

PETITION FOR WRIT OF CERTIORARI

To the United States Court of Appeals for the Seventh Circuit.

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COMMISSIONER OF INTERNAL REVENUE,
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No. .....,

PETITION FOR WRIT OF CERTIORARI

To the United States Court of Appeals for the Seventh Circuit.

To the Honorable the Chief Justice and the Associate Justices of the Supreme Court of the United States:

Your petitioner, Obear-Nester Glass Company, a Missouri corporation, whose principal place of business is in East St. Louis, Illinois, respectfully prays that a Writ of Certiorari issue to review the judgment of the United States Court of Appeals for the Seventh Circuit in the

cause styled "Commissioner of Internal Revenue, Petitioner, v. Obear-Nester Glass Company, Respondent," reversing the decision of The Tax Court of the United States.

OPINIONS OF COURTS BELOW.

The opinion of The Tax Court of the United States is reported in 20 T. C. 1102 and also appears at page 2 of the Transcript of Record herein.

The opinion of the Court of Appeals for the Seventh Circuit (appended hereto) is not yet reported.

JUDGMENT BELOW.

The judgment of the Court of Appeals for the Seventh Circuit, review of which is herein prayed, is dated, and was entered on, November 15, 1954.

STATUTORY JURISDICTION TO REVIEW.

The jurisdiction of this court is invoked under Section 1254 of the Judicial Code (Act of June 25, 1948, Chapter 646, 62 Stat. 928, 28 U. S. C. A. 1254).

QUESTION PRESENTED FOR REVIEW.

Are punitive damages recovered under the federal antitrust laws income within the meaning of the Sixteenth Amendment to the Constitution and subject to tax under Chapter 1 of Subtitle A of the Internal Revenue Code?*

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* References herein made to the Internal Revenue Code are to the Internal Revenue Code of 1939, which is applicable to the taxable year here involved.

CONSTITUTIONAL PROVISION, STATUTES, AND REGULATION INVOLVED.

Sixteenth Amendment to the Constitution:

Income Tax. The Congress shall have power to lay and collect taxes on incomes, from whatever source derived, without apportionment among the several States, and without regard to any census or enumeration.

Internal Revenue Code:

Sec. 22. Gross Income.

(a) General Definition.—"Gross income" includes gains, profits, and income derived from salaries, wages, or compensation for personal service (including personal service as an officer or employee of a State, or any political subdivision thereof, or any agency or instrumentality of any one or more of the foregoing), of whatever kind and in whatever form paid, or from professions, vocations, trades, businesses, commerce, or sales, or dealings in property, whether real or personal, growing out of the ownership or use of or interest in such property; also from interest, rent, dividends, securities, or the transaction of any business carried on for gain or profit, or gains or profits derived from any source whatever . . . (26 U. S. C. 1946 ed., Sec. 22).

Treasury Regulations 111, Promulgated Under the Internal Revenue Code:

Sec. 29.22 (a)-1. What Included in Gross Income.—Gross income includes in general compensation for personal and professional services, business income, profits from sales of and dealings in property, interest, rent, dividends, and gains, profits, and income derived from any

source whatever, unless exempt from tax by law. [See sections 22 (b) and 116.] In general, income is the gain derived from capital, from labor, or from both combined, provided it be understood to include profit gained through a sale or conversion of capital assets . . .

Clayton Act, Section 4:

Suits by persons injured; amount of recovery. Any person who shall be injured in his business or property by reason of anything forbidden in the antitrust laws may sue therefor in any district court of the United States in the district in which the defendant resides or is found or has an agent, without respect to the amount in controversy, and shall recover threefold the damages by him sustained, and the cost of suit, including a reasonable attorney's fee (15 U. S. C., 1946 ed., Sec. 15).

STATEMENT OF THE CASE.

This case arises under the Internal Revenue Code and involves liability for income taxes for the fiscal year ended June 30, 1948.

The Tax Court of the United States, the court of first instance, had original jurisdiction of the case under the provisions of Section 272 of the Internal Revenue Code, 26 U. S. C. 1946 ed., Sec. 272.

During the fiscal year ended June 30, 1948, petitioner received $1,000,000 from Hartford-Empire Company in settlement of petitioner's suit against Hartford for threefold the damages sustained by reason of acts committed by Hartford in violation of the antitrust laws. In addition, petitioner also recovered upon the settlement costs of its suit, including a reasonable attorney's fee, in the amount of $206,351.24.

The Commissioner of Internal Revenue included in petitioner's gross income for said fiscal year the entire amount received, totaling $1,206,351.24, and deducted $162,991.13, the amount of costs actually paid by petitioner during the fiscal year. $43,360.11 of the $206,351.24 petitioner received from Hartford for costs had not been expended during the fiscal year and petitioner conceded that this balance constituted taxable income.

Before the Tax Court petitioner adduced no evidence whether its actual damages resulted from injury to its capital or to its income, or that the actual damages exceeded or did not exceed the cost to petitioner of any capital or property damaged or destroyed by said Hartford-Empire Company's unlawful acts.

The Tax Court held that the actual damages recovered by petitioner constituted taxable income, but that the excess, exemplary or punitive damages included in the $1,000,000, did not constitute taxable income. The Tax Court allocated one-third of the settlement ($333,333.34) to actual damages and two-thirds ($666,666.66) to punitive damages (Record, p. 10).

The Respondent petitioned the Court of Appeals for the Seventh Circuit for review of the decision of The Tax Court, and said Court of Appeals heard the case upon his petition. There was no controversy concerning the evidence. The only question presented to the Court of Appeals was whether or not two-thirds of the damages recovered in a suit for violations of the federal antitrust acts, being the exemplary or punitive part of such damages, constituted taxable income. Petitioner not having asked for any review of the decision of The Tax Court, the question whether the actual damages constituted income was not considered.

The Court of Appeals for the Seventh Circuit, in its opinion entered November 15, 1954, reversed the decision of the Tax Court, concluding that the punitive damages involved are included in "income" as used in the Sixteenth Amendment, and that Congress had covered it in Section 22 (a) of the Internal Revenue Code (Opinion appended hereto).

REASONS FOR ALLOWANCE OF WRIT.

1. **The Court of Appeals for the Seventh Circuit has rendered a decision in conflict with the decisions of the Court of Appeals for the Third Circuit on the same matter.**

In **Commissioner v. Glenshaw Glass Co.** and **Commissioner v. Wm. Goldman Theatres, Inc.**, decided in one opinion on April 26, 1954, 211 F. (2d) 928, the Court of Appeals for the Third Circuit held that amounts recovered for violations of the federal antitrust laws, to the extent they exceed actual damages, by virtue of section 4 of the Clayton Act do not constitute income to the recipient and thus are not taxable.

The decision of the Court of Appeals in this case is directly opposite to those decisions and it is important that this court resolve the conflict. The court below has expressly refused to follow, and denied the authority of, the decisions of the Court of Appeals for the Third Circuit, and has declared to be error the Tax Court's reliance upon decisions of that court.

On October 14, 1954, this court granted the Commissioner's Petition for a Writ of Certiorari in **Commissioner v. Glenshaw Glass Co.**, 211 F. (2d) 928. The case is now pending before this court, Docket No. 199. The decision of the Court of Appeals in this case should not be permitted to become final while the question of law involved is awaiting determination by this court.

2. **The Court of Appeals for the Seventh Circuit has decided a federal question in a way in conflict with applicable decisions of this court.**

In 1913, this court, in **Stratton's Independence v. Howbert,** 231 U. S. 399, defined "income," as that term was used in the 1909 corporation excise tax law*, as:

> "The gain derived from capital, from labor, or from both combined . . ."

This same definition was applied in **Eisner v. Macomber,** 252 U. S. 189, under the 1913 income tax act, in **Merchants' Loan & Trust Company v. Smietanka,** 255 U. S. 509, under the Constitution and the 1916 income tax act and in many other cases too numerous to cite.

This definition has been construed by Congress and rephrased in section 22 of the Internal Revenue Code, to define income as "gains * * * derived from any source whatever."

The Court of Appeals did not hold that there were "sources" other than capital or labor from which income could be "derived," but, rather, that any gain is income, even if not **derived** and not from any **source,** unless some express provision of the Constitution or the Internal Revenue Code exempts such gain from taxation.

The exemplary damages awarded to petitioner under the federal antitrust laws were not derived from a source —as capital or labor—nor did they become petitioner's income by virtue of payment alone.

The Court of Appeals' action in including these damages in income conflicts with this court's definition and expressed concept of income as that term is used in the

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* Corporation Excise Tax Act of Aug. 5, 1909, c. 6, Sec. 38, 36 Stat. 11, 112.

Sixteenth Amendment to the Constitution, with Congress' definition and expressed concept of income in the Internal Revenue Code, and with the meaning of the term according to common understanding.

PRAYER FOR RELIEF.

Wherefore, your petitioner respectfully prays that a Writ of Certiorari be issued out of and under the seal of this Honorable Court, directed to the United States Court of Appeals for the Seventh Circuit, commanding that court to certify and to send to this court for its review and determination, on a day certain to be therein named, a full and complete transcript of the record and all proceedings in the case numbered and entitled on its docket, No. 11140, **Commissioner of Internal Revenue, Petitioner, v. Obear-Nester Glass Company, Respondent,** and that the said judgment of the United States Court of Appeals may be reversed by this Honorable Court.

OBEAR-NESTER GLASS COMPANY,
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APPENDIX.

In the
United States Court of Appeals
For the Seventh Circuit.

No. 11140. October Term and Session, 1954.

Commissioner of Internal Revenue,
Petitioner,
vs.
Obear-Nester Glass Company,
Respondent.

Petition for Review of a Decision of the Tax Court of the United States.

November 15, 1954.

Before Duffy, Chief Judge, Major and Swaim, Circuit Judges.

Swaim, Circuit Judge: The respondent, Obear-Nester Glass Company, a Missouri corporation whose principal place of business is in Illinois, brought suit against the Hartford-Empire Company for treble damages under the federal anti-trust laws. The Hartford-Empire Company eventually paid petitioner $1,000,000 in full settlement of the claim. The parties agree that one-third of the settlement represents respondent's actual damages but not a recovery of capital, while the remainder represents punitive (treble) damages recoverable under the anti-trust laws.

Of this recovery, respondent insists that it should be required to pay income tax on only the one-third received in settlement for actual damages incurred. The Commissioner claimed that the entire $1,000,000 was taxable as income: the amount representing punitive damages as well

as that for actual damages. The Tax Court overruled the Commissioner and held that only the amount recovered for actual damages was taxable. **Obear-Nester Glass Co. v. Commissioner of Internal Revenue,** 20 T. C. 1102. From the Tax Court's decision the petitioner appeals to this court.

There is no dispute over the facts. The only question before us is whether or not punitive damages awarded under the federal anti-trust acts constitute gross income within the definition of that term found in Section 22(a) of the Federal Income Tax Law, 26 U. S. C. A., Sec. 22(a).

Before the Sixteenth Amendment Congress could not levy a direct tax without apportionment among the states. **Pollock v. Farmers' Loan & Trust Co.,** 157 U. S. 429, 158 U. S. 601. The Amendment allows a tax on "income" without apportionment, but an unapportioned direct tax on anything that is not income would still, under the rule of the **Pollock** case, be unconstitutional.

Since 1940 the Tax Court has held that punitive damages are not income, while the Commissioner has continued to tax them as such. The Tax Court's position was originally based on **Central R. Co. v. Commissioner of Internal Revenue,** 3 Cir., 79 Fed. (2d) 697, a case not involving punitive damages. In that case the corporate taxpayer, in a settlement of an action brought to recover profits made by a fiducial employee in transactions by him in a conspiracy to defraud the taxpayer, received more than $450,000. The court held that this recovery was not taxable as income. Its decision was based on the definition of income in **Eisner v. Macomber,** 252 U. S. 189, 207: that income is "gain derived from capital, from labor, or both combined." The court in the **Central Railroad** case felt that the recovery there was derived from neither capital nor labor.

In **Highland Farms Corporation v. Commissioner of Internal Revenue**, 42 B. T. A. 1314, 1322, the Board of Tax Appeals, for the first time, held that punitive damages were not income, giving no reason other than the **Central Railroad** case. This holding was followed in **Glenshaw Glass Co. v. Commissioner of Internal Revenue**, 18 T. C. 860, 868, and **William Goldman Theatres, Inc., v. Commissioner of Internal Revenue**, 19 T. C. 637. These two cases were considered together and affirmed in one opinion, 3 Cir., 211 Fed. (2d) 928. On the surface the authorities seem to be unanimous that punitive damages do not constitute income, but while these cases were being decided another doctrine was becoming established.

In **Park and Tilford Distillers Corp. v. United States**, 107 Fed. Supp. 941, the United States Court of Claims held that "insider profits," awarded under Section 16(b) of the Securities and Exchange Act of 1934, 15 U. S. C. A., Sec. 78p(b), were taxable to the recipient corporation as income. The same holding was made in **General American Investors Co. v. Commissioner of Internal Revenue**, 2 Cir., 211 Fed. (2d) 522. Section 16(b) of that Act provides that directors, officers or persons owning ten per centum or more of the stock of a corporation shall turn over to the corporation any profit made on any purchase and sale of stock of said corporation made within a six-month period. Its obvious purpose is to protect "outside" shareholders from "insiders" who could use their superior knowledge of and control over the corporation's future plans to make personal profits by short term dealings in its securities. To effectuate this policy the Act provides that the profits so made shall be turned over to the corporation. The prime purpose of the Act is punitive, to discourage dealings of this type by persons having inside information as to the affairs of the corporation. Clearly the purpose is not compensatory. Damage to the remaining stock is not a prerequisite to recovery.

In **Goldman Theatres**, 19 T. C., at page 641, the court tried to distinguish these cases from the punitive damages cases by saying that "* * * the taxpayer did not receive the money in payment of punitive damages, but pursuant to a statute which provided that certain profits realized by corporate insiders under circumstances there present should 'inure to and be recoverable by' the corporation." Admittedly the facts are different, but the Tax Court has not pointed to any distinction that would justify a difference in treatment as to taxation of the two types of gain. On appeal the Court of Appeals also tried to distinguish the two doctrines. **Commissioner of Internal Revenue v. Glenshaw Glass Co. and Commissioner v. Goldman Theatres**, 3 Cir., 211 Fed. (2d) 928, 932. The court cited the concurring opinion of Judge Murdock in **General American Investors Co. v. Commissioner**, 19 T. C. 581, 587, which pointed to the language of Section 16(b) saying that "any profit realized" shall be paid to the corporation. Judge Murdock apparently considered "insider profits" taxable, not as windfalls, but as "profits." The respondent, in effect, makes the same argument when he claims that Section 16(b) operates on a trust fiction. The fallacy in this contention was clearly shown in the opinion on the appeal, **General American Investors Co. v. Commissioner**, 2 Cir., 211 Fed. (2d) 522, 524. The court there said:

> "Perhaps reluctant to take a position seemingly inconsistent with prior decisions of the Tax Court, which relied heavily upon the **Eisner v. Macomber** definition and upon **Central R. Co. of New Jersey v. Commissioner** (citation), the concurring judges below took the view that these payments were 'profits,' because Section 16(b) provided that any profit 'realized' under circumstances here present 'shall inure to and be recoverable by the insurer.' But this reasoning will not bear analysis. These payments were not 'profits' to petitioner, although they represented 'profits' realized by the director and the stockholder."

We agree with the Second Circuit that awards under Section 16(b) do not represent profits to the corporation which receives them.

We are unable to reconcile the taxability of "insider profits" with the nontaxability of punitive damages. We could, of course, point out the factual difference between the two situations, but we are unwilling to rest a decision on words alone when they express no rational distinction for purposes of taxation. As a result, we can only view the problem presented by this appeal as one upon which the authorities are in conflict.

The respondent contends that a tax on punitive damages would be unconstitutional because punitive damages are not income and, thus, not within the Sixteenth Amendment. The first question is: which definition of income is controlling, that of Congress or that of the Supreme Court? Since the judiciary is traditionally charged with the responsibility of interpreting the Constitution, we shall assume, for the purposes of this decision only, that, because the Sixteenth Amendment is limited to income, Congress may not tax directly without apportionment that which the Supreme Court does not so define.

The conflict centers around two different interpretations of the definition of income in **Eisner v. Macomber,** supra. In **Central R. Co. v. Commissioner,** 3 Cir., supra, the case upon which the nontaxability of punitive damages is based, the court treated the definition as if the Supreme Court had intended it to be all inclusive. Since the gain involved in that case did not fall within the definition it could not be income and was, therefore, not taxable. In **General American Investors Co. v. Commissioner,** 2 Cir., supra, the court thought that the Supreme Court did not intend that the definition be all inclusive. The court there admitted that the gain involved did not fall within the

Eisner definition but they nevertheless held that it was taxable income.

In **Eisner v. Macomber** the Supreme Court was faced with the problem of distinguishing between a capital gain and income derived from capital. Having made the distinction the Court wanted to establish which was taxable and which was not. For this purpose it looked to a definition in Webster's International Dictionary, which had already been repeated in two cases, that income was gain derived **from** capital or labor. The Court was not primarily interested in defining income according to its source, but wanted to show that income attributable to capital must be derived **from** capital, and, therefore, an increase in capital which could not be separated from it was not income. The borrowed definition served its purpose in separating the gain attributable to capital which was taxable as income from that which was not.

In **Helvering v. Bruun,** 309 U. S. 461, the Court refused to treat the **Eisner v. Macomber** definition as all inclusive. In that case a landlord was taxed for the increased value of repossessed land on which the tenant had put a building. Citing **Eisner v. Macomber,** at pages 468-9, n. 8, the Court said:

> "* * * These expressions, however, were used to clarify the distinction between an ordinary dividend and a stock dividend. They were meant to show that in the case of a stock dividend, the stockholder's interest in the corporate assets after receipt of the dividend was the same as and inseverable from that which he owned before the dividend was declared. We think they are not controlling here."

In **James F. Waters, Inc., v. Commissioner of Internal Revenue,** 9 Cir., 160 Fed. (2d) 596, 597, the court also interpreted the definition as covering only part of income.

"The final argument on this phase is that the insurance proceeds constitute an indemnification of the taxpayer for the loss of its president, and are not income within the intendment of the Sixteenth Amendment. **Eisner v. Macomber** (citation) is relied on as authority. While this decision has displayed an unexpected vitality within the limits of its particular facts, the lower federal courts would hardly be justified in extending its doctrine to wider fields."

After **Eisner v. Macomber** the Board of Tax Appeals itself said in **Hawkins v. Commissioner of Internal Revenue**, 6 B. T. A. 1023, 1024:

> "* * * Whether this description of income (the **Eisner v. Macomber definition)** is to be regarded as exclusive of everything not clearly within its terms, so that both the Sixteenth Amendment and the statute (which is said to be the fullest exercise of the constitutional power [citations]) are forever to be limited by a judicial definition, may still be doubtful, for the Supreme Court is not in the habit of defining words abstractly, but only for the purpose of determining whether the matter then under consideration comes within their fair intendment. * * * there may be cases in which taxable income will be judicially found although outside the precise scope of the description already given."

In Magill, Taxable Income, at page 67, the author speaks of **Eisner v. Macomber** as "a futile attempt to confine a term that must remain elastic." This criticism is justified only if the Court in that opinion intended that its definition be all encompassing.

We feel, as do the courts cited above, that the Supreme Court in **Eisner v. Macomber** was merely borrowing a definition of income to support its holding that income

attributable to capital must come from it, i. e., be separately expendable, and that it did not consider that definition all encompassing. Even as to income derived from capital the **Eisner** case has been limited to its specific facts. **Helvering v. Bruun**, 309 U. S. 461; **Koshland v. Helvering**, 298 U. S. 441. In **Helvering v. Griffiths**, 318 U. S. 371, 375, the Court, speaking of the **Koshland** case, supra, said:

> "She argued that her dividend, notwithstanding **Eisner v. Macomber**, to which she gave a narrow reading, was constitutionally taxable as income at the time received. The Court held unanimously and squarely that the dividend in question did not constitute income within the Sixteenth Amendment, and in effect limited **Eisner v. Macomber** to the kind of dividend there dealt with."

We do not believe that the Supreme Court intended to define income exclusively according to its source. The great argument which resulted in this country's adoption of an income tax, and the fundamental principle upon which that tax is still based, is that individuals will be taxed according to their ability to pay. **Cole v. Commissioner of Internal Revenue**, 9 Cir., 81 Fed. (2d) 485, 487. See Mertens, Law of Federal Income Taxation, Section 1.03, especially note 38. There is no rational connection between the source of the taxpayer's gain and his ability to pay. The question is: has he realized an economic gain, from whatever source, which leaves him better able to contribute to the support of his government?

Of course, gains from some sources are not taxable, but the reason is not that they don't constitute income, but rather that either the Constitution or Congress forbids the collection of the tax on income from those particular sources.

If gain not derived from capital or labor is excluded from taxation, the burden on income that is derived from these sources will, of course, be all the greater. We feel, as did the Court of Claims in **Park & Tilford v. United States,** 107 F. Supp. 941, 942, that: "If Congress were to select one kind of receipt of money which, above all others, would be a fair mark for taxation, it might well be 'windfalls'." There can be no question that the punitive damages recovered by the respondent here greatly enhanced its ability to pay. Realizing that one reason for the adoption of the Sixteenth Amendment was to place the burden of taxation according to the ability to pay, we cannot believe that the term "income" as used in that Amendment was not intended to include the type of gain involved here.

There can be little doubt that Congress intended to include the punitive damages, here involved, in income if it had the constitutional power to do so. Section 22(a) of the Internal Revenue Code provides:

> " 'Gross income' includes gains, profits, and income derived from salaries, wages, or compensation for personal service * * * of whatever kind and in whatever form paid, or from professions, vocations, trades, businesses, commerce, or sales, or dealings in property, whether real or personal, growing out of the ownership or use of or interest in such property; also from interest, rent, dividends, securities, or the transaction of any business carried on for gain or profit, **or gains or profits and income derived from any source whatever.**" 26 U. S. C. A., Sec. 22(a). (Emphasis added.)

The Supreme Court has said that Congress in defining "gross income" in Section 22(a) intended to use its taxing power to its fullest measure. **Helvering v. Clifford,** 309 U. S. 331, 337.

The respondent suggests that by allowing the taxation of treble damages awarded under the anti-trust acts, we would be defeating Congress' attempt to encourage the prosecution of violators of these acts. The first answer to this contention is that once it is established that the award involved here is income and comes within the coverage of Section 22(a), Congress must specifically provide for its exclusion or deduction by statute if it so desires. We might further say that the principal purpose of treble damages seems to be punishment which will deter the violator and others from future illegal acts. Compensation for actual damages is enough to encourage legal action, not to mention the substantial amount of punitive damages the injured party still retains after taxes are paid.

Respondent's argument works against it, for if, as respondent suggests, punitive damages were intended principally to encourage the uncovering of anti-trust violators, then it might be said that the taxpayer "earned" the punitive damages by prosecuting the action for the recovery. If this interpretation were made, the punitive damages here would fall within the **Eisner v. Macomber** definition as gain derived from labor.

We believe that the award involved here is included in "income" as used in the Sixteenth Amendment, and that Congress has covered it in Section 22(a) of the Internal Revenue Code.

The decision of the Tax Court is, therefore, **Reversed** and the cause is remanded for further proceedings consistent with the views expressed in this opinion.

MOTION FILED MAR 3 1955

SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1954

No. 478

OBEAR-NESTER GLASS COMPANY
Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SEVENTH CIRCUIT

MOTION FOR LEAVE TO FILE SUPPLEMENT TO PETITION FOR WRIT OF CERTIORARI AND SUPPLEMENT TO PETITION

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SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1954

No. 478

OBEAR-NESTER GLASS COMPANY
Petitioner,

v.

COMMISSIONER OF INTERNAL REVENUE

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SEVENTH CIRCUIT

MOTION FOR LEAVE TO FILE SUPPLEMENT TO PETITION FOR WRIT OF CERTIORARI

Comes now the Petitioner in the above-entitled cause by its counsel, and respectfully prays for leave to file Supplement to its Petition for Writ of Certiorari, heretofore, on December 13, 1954, filed in this Court.

In support of said Motion, Petitioner shows the Court that:

1. On December 13, 1954 the Petitioner filed in this Court a Petition for Writ of Certiorari to the United States Court of Appeals for the Seventh Circuit.

2. At the time this Petition was filed this Court had already issued a Writ of Certiorari to the United States Court of Appeals for the Third Circuit in the cases of *Commissioner of Internal Revenue* v. *Glenshaw Glass Company and Commissioner of Internal Revenue* v. *William Goldman Theatres, Inc.*

3. The Commissioner of Internal Revenue on December 30, 1954, filed a memorandum stating that the Commissioner did not oppose the granting of certiorari in the above-entitled cause because the Petition in this case and in No. 199 presented the same question, i.e.

> "whether punitive damages received in connection with the settlement of a suit for treble damages under the federal antitrust laws constitute taxable income."

4. The Court has neither granted nor denied the Petition of the Petitioner.

5. On February 28, 1955 the Court heard argument on the merits in the case of *Commissioner of Internal Revenue* v. *Glenshaw Glass Company* and *Commissioner of Internal Revenue* v. *William Goldman Theatres, Inc.* (No. 199). The parties to that case had previously submitted Briefs on the Merits.

6. Counsel for the Petitioner has the impression that the Court may dispose of the above-entitled case in accordance with its decision in No. 199, and desires to submit matters not fully covered by counsel in the case of *Commissioner of Internal Revenue* v. *Glenshaw Glass Company* and *Commissioner of Internal Revenue* v. *William Goldman Theatres, Inc.* nor by the Petitioner in the abbreviated statement in the original Petition for certiorari as to why the writ should be granted.

WHEREFORE Petitioner respectfully prays that this Honorable Court grant this Motion for Leave to File Supplement to Petition for Writ of Certiorari.

Respectfully submitted,

HENRY C. LOWENHAUPT,
Attorney for Obear-Nester Glass Company, Petitioner.

SUPPLEMENT TO PETITION

The single question presented in this case is whether or not punitive damages received were *income* within the meaning of that word as used in the Sixteenth Amendment to the Constitution or in the definition in section 22(a) of the Internal Revenue Code of 1939. If the constitutional meaning differs from the statutory definition, then the former must control since obviously the statutory definition does not extend the constitutional meaning and the statute does not purport to tax as income that which is not income.

This is not to say that Congress can tax only income, for it can and does impose numerous taxes other than the income tax. There is no argument presented that Congress could not include the receipt under discussion in the measure of a tax within its power. But the tax here asserted is a tax measured by income, not an excise such as a business or stock tax. Unless punitive damages recovered under the federal anti-trust laws are income, they are not taxable as such. The following considerations are material to the determination of the question and ought to be considered by the court.

A. *The definition of income.*

There has probably been as little variety in the definition of income expressed by the courts as in the definition of any word. It has been defined as the "gain derived from

capital, from labor, or from both combined." The proviso, sometimes expressed, to include capital gains is not here material. The word "income" had a meaning at the time of the adoption of the Sixteenth Amendment and it continues to have the same meaning.

It is recognized that any definition serves a limited purpose and that the fundamental words of language are not susceptible of exact definition. No definition alone can explain the meaning to one not informed on the subject, for understanding of words is gained by experience. Thus, a child is not aided in learning that a cat is not a dog by being told that a dog is a canine. Rather, the meaning grows by observation, as the child observes many animals called "dogs" and others called "cats" and learns to recognize the pertinent, distinguishing characteristics.

The same is true of the understanding of the word "income," which could not be conveyed by any definition to one not familiar with the concept. Rather, the understanding grows by observation and certain characteristics appear which distinguish income from other receipts.

So the statutory definition of income has developed in phraseology patterned after this court's definition quoted above, the definition in the Act of March 2, 1867, and other definitions and observations now in history. It begins in the modern era of income taxation with the definition in the Tariff Act of 1913. It continues in much the same form to and including the Internal Revenue Code of 1939, in which the definition appears in section 22(a), and remains without altered meaning in section 61 of the Internal Revenue Code of 1954. The language of the statutes confirms the concept of income which has been developed over the past century, and the list of items included shows the nature of receipts which are considered income.

The historical development of the concept of income for purposes of taxation, the cumulation over many years of

experience, both before and after 1913, of instances of income and non-income, has resulted in the appreciation that three elements must be present in order that income may exist. These elements are (1) gain, (2) derived, (3) from a source.

The elements have been considered, one by one, over the now long history of income taxation. It was early established that unless there was *gain,* there was no income subject to tax. It was so ruled in *Doyle* v. *Mitchell Bros. Co.,* 247 U.S. 179, 185 (1918), as follows:

> "Whatever difficulty there may be about a precise and scientific definition of 'income,' it imports, as used here, something entirely distinct from principal or capital either as a subject of taxation or as a measure of the tax; conveying rather the idea of *gain or increase* arising from corporate activities."

Then it was asserted that mere gain might be income; an assertion promptly answered with the requirement that to be income the gain must be derived. *Eisner* v. *Macomber,* 252 U.S. 189, 207 (1920), ruled:

> "Here we have the essential matter: *not* a gain *accruing* to capital, not a *growth* or *increment* of value *in* the investment; but a gain, a profit, something of exchangeable value *proceeding from* the property, *severed from* the capital, however invested or employed, and *coming in,* being *'derived,'* that is, *received* or *drawn by* the recipient (the taxpayer) for his *separate* use, benefit, and disposal; *that* is income derived from property. Nothing else answers the description.
>
> "The same fundamental conception is clearly set forth in the 16th Amendment—'incomes, *from* whatever *source derived*'—the essential thought being expressed with a conciseness and lucidity entirely in harmony with the form and style of the Constitution."

Now it is asserted that the existence of a source, even the existence of gain, is immaterial to the existence of income.

The language quoted above from *Eisner* v. *Macomber* emphasizes the materiality of the *three* elements. *Lucas* v. *Earl,* 281 U.S. 111 (1930), holding that salary is taxable to the person who earns it, concedes the necessity of a source in the concept of income. Fruits are not attributed to a different tree from that on which they grew. The fruits—namely, the income—must obviously grow on some tree which is the source. In *Irwin* v. *Gavit,* 268 U.S. 161 (1925), it was held that the beneficiary of a trust entitled to the income of an estate for a limited period of years was taxable upon the income. The reasoning of the case indicates the fundamental recognition that the income must be derived from a source, namely, the principal fund. The necessity of a source was most recently recognized by this Court in *Holland* v. *U.S.,* 348 U.S. 121 (1954), 99 L. Ed. 127, 138, in language as follows:

> "Increases in net worth standing alone cannot be assumed to be attributable to currently taxable income, but proof of a likely *source from which the jury could reasonably find that the net worth increases sprang* is sufficient." (Emphasis supplied.)

In that case and in the related cases involving the question whether or not proof of unreported increases in net worth was sufficient to sustain a conviction of income tax fraud, the Court insisted upon there being a basis to support the jury's finding that there was a *source* of net income.

The language used in the Sixteenth Amendment adopted in 1913 and the reasoning of the Court as recently as 1954 indicate the consistent thesis that, in order for even a derived gain to be income, it must be from a source. The conventional definition of income expressed in *Eisner* v. *Macomber,* supra, describes the sources as capital or labor. The statutory definition uses the phrase "any source what-

ever." *The two expressions are the same in meaning, since no one has yet been able to imagine a source of gain other than capital or labor, or a combination of the two.*

The necessity of a *source*, and descriptions of characteristic sources, of income, are expressly set out in section 119 of the Internal Revenue Code of 1939 (now sections 861 and 862 of the Internal Revenue Code of 1954), which has remained substantially unchanged since the Revenue Act of 1921, section 217. The Acts, relating to taxation of income of nonresident aliens, separate income into two categories: that from sources within the United States and that from sources without the United States. While the statute recognizes the possibility of sources being partly within and partly without the United States, the notion that gain from no source could exist as income has not entered into the statute.

It therefore appears that the concept of a source has always been and still is embedded deeply in the understanding conveyed by the word "income." Capital and labor (broadly intended) are the sources from which all income heretofore considered has been derived. The characteristics of these sources point up the meaning and significance of "source." A source is that from which anything comes forth—regarded as its cause or origin. It is so defined in Webster's International Dictionary (1928), and the word conveys to the experienced understanding the picture of a well from which water may be drawn repeatedly without appreciably impairing the source or reservoir of water still available. The concept of "source" gives rise to the characteristic of income—that it is periodic, repetitious, and may be derived again and again from the same source—a characteristic which was emphasized in *U.S.* v. *Supplee-Biddle Hardware Co.*, 265 U.S. 189, 195 (1924), in which it was held that the proceeds of life insurance received by a corporation were not taxable income, notwithstanding that

the statutes exempted only proceeds of life insurance paid to *individual* beneficiaries. The court reasoned:

> "The benefit to be gained by death has no periodicity. It is a substitution of money value for something permanently lost, either in a house, a ship, or a life. Assuming, without deciding, that Congress could call the proceeds of such indemnity income, and validly tax it as such, we think that, in view of the popular conception of the life insurance as resulting in a single addition of a total sum to the resources of the beneficiary, and not in a periodical return, such a purpose on its part should be express, as it certainly is not here."

Compare *Gray* v. *Darlington*, 15 Wall. 63, holding capital gains, in the absence of express provision in the statute, not to be income, because they are not "annual." The purpose of the statute is primarily to tax "annual" gains.

It therefore appears that three characteristics of income have persisted from a time prior to the beginning of the income-tax law to the present time. They are: (1) gain; (2) derived; (3) from a source. Each characteristic is not necessarily an air-tight compartment, for most, possibly all, gains are from sources, and it is doubtful that any gain firmly exists before derivation. They have been expressed in the Sixteenth Amendment and have furnished the consistent basis of decisions of this court and the understanding of the word "income." It is now asserted that the elements are immaterial and that one person's increment of values, that is, a mere transfer of wealth, is taxable as income. This is obviously not true according to the decisions or popular understanding. *Doyle* v. *Mitchell Bros. Co.*, supra, 247 U. S. 179, 185 (1918). As stated in *Southern Pacific Company* v. *Lowe*, 247 U. S. 330, 335 (1918):

> "We must reject in this case, as we have rejected in cases arising under the Corporation Excise Tax Act

of 1909 (citations omitted), the broad contention submitted in behalf of the government that all receipts —everything that comes in—are income within the proper definition of the term 'gross income,' * * *."

1. *The penalty had no source.*

As pointed out above, the characteristic, if not the only, sources from which income can be derived, are capital and labor. There was and is no source from which the receipts here under discussion were derived.

The receipts under discussion are exactly analogous to the receipt discussed in *U. S.* v. *Supplee-Biddle Hardware Co.*, 265 U. S. 189, 195 (1924), and the language and reasoning of the Court in that case are exactly pertinent to this case. In that case the Court held that the proceeds of insurance, whether or not they could constitutionally be classified as income, were not within the broad language of the statutory definition of income. By the same token, whether or not the receipts involved in these cases may constitutionally be classified as income, they so lack the characteristics of income that they are not within the broad definition of the statute. The source of income, as capital or labor, permits that gains be repeatedly derived from it. Whatever the alleged origin of the payments made because of the exemplary or punitive provisions of the anti-trust laws, it lacks the characteristic of a source, in that it was exhaused by the receipt. Even in the case of capital gains, the investment must first be restored before income is realized, thus permitting the realization of another gain by reinvestment of the original capital.

It is therefore clear that a law suit cannot be considered the *source* of a receipt, any more than an account receivable or a promissory note may be considered the *source* of payment in discharge of the account or note. If the account or note is collected by suit, the law suit cannot be con-

sidered a source of the collection. The account, the note, and the law suit are all equally exhausted by payment. They are but means of collection.

Nor are the anti-trust laws a "source" of income. They are not capital, labor, property, or business, but merely establish the right to receive the payment, because of the prohibited acts of another.

The source of income most nearly related to the receipts here under discussion was the business of the violator of the anti-trust laws—its patents, secret processes, and other capital and business. From them, income was concededly derived. All of such income has been taxed. The amount of income allocable to the injured party cannot exceed the actual damages which it suffered, for the source gave rise to no more. If it be assumed for simplicity that all of the malfeasor's income was illegally derived and all of it resulted, in exact correspondence, in loss of profits to its victims, then the total actual damages of all of them would equal its total income, but all of its victims would recover from it three times its income. The only gain derived from the malfeasor's business is the actual income, which may be conceded in these cases to correspond to the actual damages. Alternatively, the actual damages may have been income in a prior year, or included in deductions from such income; thence taxable in the year of recovery. This presents a question of *when* income is derived and taxed, not whether or not there is income.

2. *The penalty was not gain.*

In every income-tax case, at least two questions are presented which should not be confused: *first*, is there income or gain, and, *second*, if there is, to whom is it taxable? In the present case, no controversy arises upon the second question. The Petitioner has conceded that there is income to the extent of the *actual* damages which

it has recovered and that such income is taxable to Petitioner without regard to whether or not it may also have been taxed to the anti-trust law violator. But there was no income pertinent to the issues in this case in excess of the actual damages.

For simplicity, we may assume that two individuals go into separate businesses, each with $1,000. The first individual, by violations of the anti-trust laws, derives profits of $300, which without his violation would have accrued to the second. The second, therefore, recovers judgment against the first in the amount of $900, and after payment the first has remaining $400 while the second has $1900. The total gain of the two is only $300, and upon any concept of income which includes gain as an element there has been only $300 of income. To assert that $900 is taxable to the second individual is to assert that any payment is income even without gain. The assertion has been repeatedly rejected.

Analogous situations arose in *Helvering* v. *Butterworth*, 290 U. S. 365 (1933), in which it was held that an annuity does not constitute income; and *Gould* v. *Gould*, 245 U. S. 151 (1917), in which it was held that alimony did not constitute income. Congress has recognized the necessity of *gain* in taxing an annuitant only upon the interest factor in the payments. Section 22(b)(2), Internal Revenue Code of 1939.

Thus, the classic concept of income from capital or labor demonstrates the necessity of gain. A laborer improves the value of his employer's materials by processing them. The gain in value is shared as the laborer's wages and the employer's profit. A fruit tree—capital —blossoms and bears fruit. The value of the fruit is gain, for the tree remains. Whether the gain is taxable as income to the owner of the tree, the laborer who harvests the fruit, or to some other person, or even to several

persons, is a question not to be considered until it is found that gain was derived from the tree.

That gain is an essential element of "income," independent of the inquiry as to when and to whom the income may be taxable, is well illustrated by the use of the word in statistical and economic publications. Thus, *Statistical Abstract of the United States, 1949* (U. S. Government Printing Office, Bureau of the Census), page 279:

> "*National income* is the aggregate earnings of labor and property which arise from the current production of goods and services by the Nation's economy. * * * Earnings are recorded in the forms in which they accrue to residents of the Nation, inclusive of taxes on those earnings."

This description, as well as others too numerous to mention, expresses the understanding of "income" in its usual and accurate sense, to mean gain; income is computed as the value of the product of the Nation's economy. If perfect accuracy were achievable, the value of the product would equal taxable income. The income is the gain.

Observe that "gain" as an element of income, is not the payment, but the value given for the payment as labor or the use of capital.

The concept of "income," as a subject to be taxed, derives from and is expressed by Adam Smith, as the beginning doctrine of *The Wealth of Nations* (New York, 1937) Introduction and Plan of the Work; page lvii:

> "The annual labour of every nation is the fund which originally supplies it with all the necessaries and conveniencies of life which it annually consumes and which consist always either in the immediate pro-

duce of that labour, or in what is purchased with that produce from other nations."

The author expresses most clearly throughout his basic work the concept of income, which is, first and foremost, gain, fundamentally the result of "labour" applied to a "capital stock." The wealth of a nation is to be measured in terms of the "annual" values achieved by the application of labor to the "capital stock which is employed in setting them (laborers) to work." Thus gain, capital and labor, or source, are tied together to make the wealth of nations, the annual income, which is the subject of taxation, in phraseology closely related to the words used by this Court and the underlying ideas of the taxation of income. Annual gain, a measure of wealth, is the subject of the income tax. Any variation of the subject of the tax is a departure from the income tax to a different tax, which, no matter how valid and defensible, is not an income tax.

Short of "gain," there is a mere circulation of money, which is not income, and is characteristically taxed by various excise taxes, as gift tax, inheritance or estate tax, stamp taxes on issue or transfer of shares of stock, real estate, bonds, notes and the like. "Circulation taxes" are well known in many economies, but have never been much favored in ours.

In the context and concept of income or annual gains, the transfer of wealth from one to another, whether as gift, inheritance, payment of insurance preceeds or penalty, is not a factor. Payment is material only in the determination of when and to whom income, established to exist, is taxable.

Congress has demonstrated its acceptance of this concept of income, and the separateness of the two questions, *first,* whether or not there is income, and *second,* to whom

is it taxable. In *Gould* v. *Gould*, 245 U. S. 151 (1917), this Court held that alimony was not taxable as income to the divorced wife who received it. Congress amended the law, providing that it was. (I. R. C. 1939, sections 22(k) and 23(n)). It would seem clear that Congress did not intend to tax as income something which was not income —alimony. It intended, as it stated, to tax income earned by the husband to the wife who received it. The income is the husband's earnings. See also *Helvering* v. *Butterworth*, 290 U. S. 365 (1933), a similar instance, where formerly trust income was taxed to the trust, but by virtue of statutory amendments has become taxable to another.

B. *Authorities.*

There are no authorities which support the argument that the punitive damages involved in this case constitute income. On the contrary, the cases dealing with the problem have all been decided the other way.

1. *Decisions Holding a Penalty Is Not Income.*

Nineteen years ago, the Third Circuit, in *Central Railroad Co. of N. J.* v. *Commissioner*, 79 F. 2d 697 (3rd Cir. 1935), held that money recovered by a corporation from an officer who had used his confidential position to enter into lucrative contracts with the corporation through dummy concerns was not income. This recovery was called a penalty imposed by the law on a faithless fiduciary. It may be argued whether or not it was in fact a penalty. It was less punitive in nature than the penalty here involved, which was clearly punitive. Nonetheless, the principle enunciated established that a penalty is not income. That principle is not impeached by a controversy whether or not that precise payment was a penalty.

Nor can *Arcadia Refining Co.* v. *Commissioner*, 118 F. 2d

1010 (5th Cir. 1941), be said to conflict with the pertinent principle of the *Central Railroad Co.* case, for in the *Arcadia* case there was no penalty involved. The corporation simply recovered from its faithless officer income which he had obtained through the use of the corporation's capital in direct competition with the corporation. The case concedes that, if the receipt had been a penalty, it would not have been income.

In *Highland Farms Corporation* v. *Commissioner*, 42 B.T.A. 1314 (1940), the Board of Tax Appeals held that punitive damages were not income. The Commissioner did not see fit to appeal that case. He merely issued his "non-acquiescence" (1941-1 C.B. 16) and now maintains that there is no longstanding rule that punitive damages do not constitute income.

This rule has existed for nineteen years. The Commissioner's non-acquiescence in the *Highland Farms* case should not be presumed a final action; it is merely the preliminary to further action—as an appeal. No appeal was taken, however. Alternative action might be the litigation of another case: No other case was litigated. Or, it might be presentation of the matter to Congress for clarification—the most direct and effective action short of an appeal. If the matter was not presented to Congress, the presumptive reason is that it was thought Congress would concur in the decision. If it was presented, Congress did concur in the decision. If the Commissioner took no action, then his non-acquiescence is contradicted by fourteen years of *de facto* acquiescence.

As the Tax Court stated:

> " . . . reasonable stability of the body of the law makes it highly desirable that recognized judicial precedents be adhered to unless clearly wrong or altered by statute." *Obear-Nester Glass Co.*, 20 T.C. 1102, No. 152 (1953).

The instances of amendments to the Internal Revenue Code following court decisions are beyond enumeration; they are most conspicuous in the Internal Revenue Code of 1954, which is replete with specific provisions made to adopt or reject the rule of a case cited in the reports of the committees. The omission of any reference to the rule of the *Highland Farms* case, coupled with specific references to other Tax Court decisions, is striking, especially in view of the fact that, when the amendments to the Code were under consideration, these cases were pending. See, for example, cases cited by the Senate Finance Committee in its Report containing the detailed discussion of Sections 172 and 267 of the Internal Revenue Code of 1954, in which it is stated that the provisions of those two sections were intended respectively to overrule *Joseph Sic* v. *Commissioner*, 10 T.C. 1096 (1948), and *Snively* v. *Commissioner*, 20 T.C. No. 18 (1953).

2. *Cases asserted to hold punitive damages to be income.*

The "insider profit" cases, *Park & Tilford Distillers Corp.* v. *United States*, 107 F. Supp. 941 (C. Cl. 1952) certiorari denied, 345 U.S. 917 (1953), and *General American Investors Co., Inc.* v. *Commissioner*, 19 T.C. 581, 211 F. 2d 522 (2d Cir. 1954), certiorari granted, 348 U.S. 812 (1954), this Term, are not pertinent to the issues involved here. Upon the analysis above outlined, those cases are very different from this case.

The "insider profit" cases arise under Section 16(b) of the Securities Exchange Act of 1934 [48 Stat. 896, 15 U.S.C. Sec. 78 p(b)] which provides that if any insider (director, officer, or the like) realizes profit on purchase and sale or sale and purchase of his corporation's securities within a six months' period, such profit shall *inure to and be recoverable by* the corporation.

Thus, in order to call the statute into play there must be

profit and that profit is clearly gain derived from capital. The insider may be taxed upon this income because he has received it. If, subsequently, he accounts to the corporation for the gain, Congress, restrained only by the due process clause of the Fifth Amendment to the Constitution, may tax the corporation on the gain. Whether this result is reached by an interpretation of the statute finding that income "inured to" and thus belonged to the corporation from the outset under a constructive trust theory, or by some other reasoning is not important here. Whether Congress does tax trust income both to the trust and to the beneficiary (as it taxes corporate income both to corporation and shareholder) is not a question of what is "income," but what is its intention, consistent with "due process of law."

The analogy between these cases and the insider profit cases lies in viewing the anti-trust law violator as the insider. The violator presumably had income from its business and paid tax upon that income. By reason of its illegal activities it was required to pay an amount equal to taxpayer's actual damages. It may be assumed that taxpayer's damages were at most equal to the malfeasor's profits. Then, the analogy of the insider profit cases would indicate, if anything, that this amount was income taxable to the taxpayer who received it.

But the issue in these cases is whether or not an additional payment—the punitive damages—is also income. The basic premise to the question in the insider profit cases and to the holding that the actual damages were taxable in these cases is missing. The punitive damages did not recompense petitioner for lost profits; the actual damages paid did that. The receipt of punitive damages by petitioner was not conditioned on the wrong-doer's having income to that extent. The purported analogy would arise only if the "insider"

were required to pay over not only the profits, but also his investment in the stock. There is no such requirement.

Indeed, no "penalty" is involved in the insider profits cases, for only income is paid over by the insider. If the gain or income is taxed twice, the tax may exceed the income, but the validity of such a tax as an income tax cannot be questioned upon the grounds that the subject of tax—gain or income—is wanting, but on utterly unrelated grounds.

The word "penalty" is not one of exact meaning. The "penalty" in each instance can be described accurately only by reference to the laws compelling its payment. The "penalties" in these cases and in the insider profits cases were detrimental to the payor, and tended to a greater or lesser degree to discourage activities deemed deleterious. Their similarity ends there. One is measured by gains or income; the other is measured to the extent of one-third, by damages suffered, and as to two-thirds by the arbitrary will of Congress.

3. *No case holds that income can exist without gain.*

This brief could be greatly extended to discuss and distinguish numerous irrelevant cases. We content ourselves with but a few brief references to the most extreme cases and the general observation that in each of those cases there was *gain* derived *from a source.* Thus, for example, in *Rutkin* v. *United States,* 343 U.S. 130 (1952), there was held to be gain from the taxpayer's labors as an extortionist. The real question in that case was whether under the reasoning of *Commissioner* v. *Wilcox,* 327 U.S. 404 (1946), it could be said that there was no gain, since Rutkin was under a legal liability to make restitution. In *Robertson* v. *United States,* 343 U.S. 711 (1952), a sum received as a prize for a symphony was held to be gain derived from labor and not a mere gift. It was held imma-

terial that the symphony was not composed pursuant to contract, as it is immaterial whether or not goods are manufactured before or after a purchaser of the goods is found. *Irvin* v. *Gravit*, 268 U.S. 161 (1925), taxed payments received pursuant to a bequest of income from a trust to the beneficiary. That there was gain and that the source was the trust capital was not questioned. It was decided that the income, which admittedly existed, was taxable to the recipient.

No case we have found supports respondent's position. The test of the rule that gain from a source is essential to the existence of income does not lie in the borderline cases, which are consistent, but in the typical cases which establish it. The doubtful, or borderline, cases involve personal receipts—as from extortion. The analogy is to income from services or work or personal effort. Generally, legitimate personal effort gives rise to values, no matter how fleeting, because, or to the extent that, a person can be found to pay for it. Thus, a mountebank or clown or musician, although his services are "non-productive" (as Adam Smith designates them), cannot deny that what he has done is worth what he has demanded and received.

The borderline cases involve *illegal* efforts. They are made illegal *because* an appropriate legislature deems that they add no value to the economy, or even destroy values in the economy. Therefore, some have thought that illegal efforts do not give rise to income, as they do not add to the values in the economy. But it does not become the enforcement of the revenues to permit the taxpayer to set up the worthlessness, much less the illegality, of his efforts for which he has demanded and received payment. It does not seem a "natural construction" of the law to "read it as permitting persons who come within its terms to defeat taxation by setting up their own wrong." *Minister of Finance* v. *Smith*, [1927] A.C. 193, 51 A.L.R. 1023 (House of

Lords, 1926). So he who renders "non-productive" effort, that is, creates very transitory values, as the mountebank, and he who renders "productive" effort, as a bricklayer who builds a factory, and he who renders even illegal effort, are alike estopped, *vis-a-vis* the other parties to those efforts and therefore *vis-a-vis* the revenues, to deny that the efforts produced, at least for an instant, the value he demanded in payment.

Similarly, the cases which hold that cancellation of indebtedness gives rise to taxation of income to the debtor are consistent, even sustain, the same concept of income. The *mere* forgiveness of indebtedness is not income; it is at most the equivalent of payment of money, and the consideration or reason for the forgiveness or payment determines whether or not there is income or gain. *Helvering* v. *American Dental Co.*, 318 U.S. 322. Thus, a discharge in bankruptcy does not cause the bankrupt debtor to have income. Clearly, however, forgiveness of indebtedness in consideration of services would be the same as payment of salary, and the services being of undeniable value, there would be gain or income.

In every case in which indebtedness is forgiven in whole or in part, there is a reason. In such a case as *United States* v. *Kirby Lumber Co.*, 284 U.S. 1, the reason was that the debtor's obligations were of a market value less than face; stated otherwise, that the interest rate was less than the market demanded; hence the obligations sold at a discount although the debtor was solvent. The discount was therefore as truly and substantially *interest* as if the debtor, instead of buying its own obligations, had lent the money so used at the higher rate. The use of money is a thing of value. Interest, paid for that use, is income.

Conclusion

For the foregoing reasons, the punitive part of the damages recovered for violations of the anti-trust laws is excluded from taxable income by the very meaning of the word "income" as developed by history, experience, the Constitutional provisions, the decisions of this Court, and the statutes enacted by Congress.

It is therefore submitted that the foregoing motion should be granted and the foregoing matters considered.

Respectfully submitted,

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MARCH, 1955.